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C O N F I D E N T I A L SECTION 01 OF 04 PRAGUE 000591

SIPDIS

EUR/CE FOR JBERGEMANN, NSC FOR JEFF HOVENIER

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SUBJECT: SCENESETTER: THE VICE PRESIDENT'S VISIT TO THE  
CZECH REPUBLIC

Classified By: Charge d'Affaires Mary Thompson-Jones, reasons 1.4 (b) a  
nd (d).

11. (C) Mr. Vice President: Your visit to the Czech Republic comes at a key moment to shape a vision for the future of our partnership. While Czech transatlanticists have expressed disappointment about the results of our missile defense policy review, they have constructively engaged with us and are seeking new avenues of cooperation. They are particularly interested in a substantive role as we develop the new missile defense and other security architecture. Czech transatlanticists worry about Russia's role in the region, particularly in energy security and organized crime. They also worry that the U.S. could be displaced by a more Brussels-oriented younger generation, and seek a way to visibly cement strong ties with the U.S.

12. (C) PM Fischer's interim government, originally due to end this month, will probably now rule until next May and is becoming more self-confident. The government recently passed a key test, gaining consensus among fractious political parties on a budgetary and austerity package, passed amid an economic downturn. The Czechs remain among our most like-minded partners in NATO and the EU, and will be receptive to your ideas about how we can work together in both fora. For the Czechs, 2009 is a year full of remembrances: the fifth anniversary of their entry into the EU, the tenth of their entry into NATO and the twentieth anniversary of the Velvet Revolution, which will be celebrated on November 17, 2009. These anchors to the West reflect the strength of our relations and are a solid basis for the future. In Prague, you will find the atmosphere ripe for discussion of our joint future: Czech officials were delighted at the news of your visit, are actively thinking about the way forward, and are eager to hear your vision.

A Capable Interim Government  
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13. (C) After Prime Minister Mirek Topolánek's government fell on March 24, President Vaclav Klaus appointed an interim caretaker government to lead until early elections. The caretaker government, led by former Director of the Czech Statistical Office Jan Fischer, took power on May 8 and had a limited mandate until early elections, which were supposed to be in early October. A decision by the Constitutional Court scuttled the October elections and a then subsequent agreement by the dominant parties in Parliament to hold early elections in November fell apart. Now, the parliamentary elections will occur most likely in May 2010. Despite its limited mandate, PM Fischer's government has proven effective and adept. Swift passage of the foreign military deployment bill and an economic austerity package proved Fischer's political acumen and bolstered his confidence as a leader. His administration appears capable of making the tough

decisions that will be necessary to complete the 2010 budget process.

#### Bilateral Relations

¶4. (SBU) Bilateral relations are strong. On April 5, 2009, the Czechs hosted POTUS and Mrs. Obama, who came to Prague with Secretary Clinton for the widely applauded U.S.-EU Summit and Ministerial. The Czech Republic remains a steady supporter of U.S. and NATO priorities. Indeed, some key current and former Czech (and Central European) leaders would prefer to see more engagement by the USG with Central Europe and have expressed this in a widely circulated Open Letter to President Obama in July 2009. Czech transatlanticists worry about Russia's role in the region, particularly in energy security and organized crime. They also worry that the U.S. could be displaced by a more Brussels-oriented younger generation, and seek a way to visibly cement strong ties with the U.S.

¶5. (SBU) The Czech Republic's November 2008 entry into the Visa Waiver Program removed a long-standing bilateral irritant. However, the proposed Electronic System of Travel Authorization (ESTA) fee contained in the Travel Promotion Act has been met with concern by Czech government officials and the travelling public, although they are content to let Brussels handle the issue.

#### Economy

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¶6. (SBU) Since the Velvet Revolution in 1989, the Czech Republic has transformed itself, with the help of significant inflows of foreign direct investment, into a vibrant market economy, with a strong manufacturing base, relatively low unemployment and a stable financial system. Per capita GDP in 2008 was USD20,858. The U.S. is the fifth largest foreign investor. Significant U.S. investments include Honeywell, Ingersoll Rand, and IBM. U.S.-Czech trade is relatively modest. The U.S. exported USD1.38 billion worth of goods in 2008 to the Czech Republic and imported goods worth USD2.57 billion.

¶7. (SBU) Following several years of strong economic performance, the small, open, export-oriented Czech economy is now struggling with the effects of the global economic downturn. The Czech Republic exports most of its products (over 80 percent) to fellow EU countries and over 30 percent to Germany alone. As Germany and Western Europe fell into a sharp recession, demand for Czech exports plummeted. Although there are signs that the worst of the economic slowdown, may be over, the economy is expected to contract by roughly four to five percent for all of 2009.

¶8. (SBU) While the IMF expects the Czech economy to grow by 1.3 percent in 2010, the Czech Ministry of Finance is forecasting a further decline of 0.5 percent, partly due to recently passed tax increases, designed to control the ballooning budget deficit. These tax increases effectively eliminated a modest fiscal stimulus program adopted earlier this year. The Czech budget deficit was only 1.2 percent of GDP in 2008 but is expected to exceed 5 percent for the next several years, putting off any realistic hope of adopting the Euro until at least 2016 or 17. Unemployment is expected to continue to rise, albeit from a relatively low level, and peak at over 10 percent early next year.

¶9. (SBU) Nevertheless, the conservative, inward-looking, Czech financial system has remained relatively healthy, and the Czech Republic is one of only four OECD countries not to have had to recapitalize its banks. Loans are almost exclusively financed through domestic deposits (the loan to deposit ratio is an extremely low 77 percent), and household

borrowing in foreign currencies is negligible. Long-term challenges include dealing with a rapidly aging population, an unsustainable pension and health care system, and diversifying the economy away from an over-reliance on manufacturing (especially the auto sector) toward a more high-tech, services-based economy. Corruption, especially in government procurement, is a continuing problem.

#### Westinghouse, An Opportunity to Expand Relations

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¶10. (SBU) Westinghouse's participation in the semi-state electricity company CEZ's tender for two new nuclear power plants, with options for three more, is a significant opportunity to greatly increase the U.S.-Czech business relationship. The tender could be worth as much as USD27.5 billion should CEZ choose to build all five plants. Bids to participate in the tender's pre-qualification stage are due October 30. The Russian AtomStroyExport and the French Areva are expected to be Westinghouse's main competitors, and the Russian Deputy PM was in Prague recently to lobby on behalf of the Russian company. The French are not expected to be far behind. Westinghouse offers the leading technology, the significant involvement of Czech companies, and enhanced energy security through diversification of suppliers.

#### Intellectual Property Rights

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¶11. (SBU) The Czech Republic is on the Special 301 IPR Watch List due to rampant DVD/CD piracy at roughly 50 outdoor markets that dot the German and Austrian borders and cater to German speaking clientele. While Czech Customs has increased raids and confiscations, the pirates have come to see this as the price of doing business. We continue to urge the Czechs to further increase costs to IPR violators through stronger criminal prosecutions, revocation of business licenses and confiscation of property used in IPR crimes.

#### Strategic Military Cooperation

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¶12. (C) Given the importance they assign to their relationship with the United States, former PM Topolanek and his government viewed missile defense as a natural,

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"symbolically important" step in the security partnership between our two countries. (Background Note: The Czech government moved quickly to negotiate and sign the Ballistic Missile Defense Agreement and the Status of Forces Agreement.

The Czech Senate ratified the agreements in November 2008; however ratification in the lower chamber was suspended due to domestic political turmoil, and outstanding questions about the new U.S. administration's plans. End Background Note.) In the wake of the results of the missile defense policy review, Czech transatlanticists have emphasized their wish to be involved in a substantive way in this new security architecture.

¶13. (C) The Czech government has already begun to think about the way forward, set forth in non-papers that they would like to use at the High Level Defense Group and Strategic Dialogue. Both meetings tentatively scheduled for the first week of November 2009.

#### Czech Cooperation in Afghanistan

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¶14. (SBU) In Afghanistan, the Czechs have approximately 500 military and civilian officials. As a result of a domestic political standoff in December 2008, Topolanek's government had difficulty passing the 2009 foreign troop deployments bill. The bill eventually passed, but it came down to the wire and ugly internal politics crept into the parliamentary debate. On a positive note, Czech troop deployment levels

for 2010 passed with little contention or fanfare in June 2009.

¶15. (SBU) The Czechs have launched a provincial reconstruction team (PRT), deployed a Special Forces unit, and sent experts to an Operational Mentoring and Liaison Team (OMLT) in Afghanistan. The PRT in Logar is the flagship of Czech involvement. Based at FOB Shank in Pole-Alam, the total strength of the Czech PRT was increased in early 2009 from about 210 to 275 and now includes four infantry platoons. The Czech PRT began operations in March 2008, a period that coincided with a deteriorating security situation in the province (Czechs suffered three KIA in the first months of operation). Despite the security challenges, the Czech PRT got off to a fast start and generally received high marks for its approach to reconstruction and partnerships with local government and tribal leaders. At the heart of the Czech PRT is its team of civilian experts (eight to ten persons strong) that possess specific skills relevant to Logar Province (agriculture, aquifer management, public health, education, etc). Many of the Czech civilian experts came from the Czech NGO community and several have extensive previous experience in Afghanistan.

¶16. (SBU) The Czech Special Forces unit, which has been deployed in its entirety for some time, will redeploy by December 2009. Defense Minister Bartak has directed that the unit be prepared to deploy again by December 2010. In addition, the Czechs are currently deploying a 100-man Mi-17 helicopter detachment to Logar and plan to deploy a maneuver OMLT by summer 2010.

#### Czech-EU Relations

¶17. (C) Czech relations with the EU have become strained over the last half year, since the March 2009 fall of the Topolánek government in the middle of the Czech EU presidency. With the fall of the Topolánek government, the Czechs lost credibility with EU partners, who questioned whether the Czechs took seriously their responsibility for leading the EU Presidency.

¶18. (C) In addition, euroskeptic President Klaus has yet to sign (and thus ratify) the Lisbon treaty, even though the treaty has passed both chambers of the Czech parliament. This matters to USG for two reasons. First, the Lisbon treaty, which outlines reforms on how the EU does business, including engagement with third countries, cannot take effect until it is fully ratified by all EU members. Second, the Czech Republic often views issues in a similar vein to the U.S. and in the past it has often willingly pressed for EU consensus positions which closely track with USG views. The Czech "troublemakers" now face added criticism for holding up the EU reform process, and appear at the moment to be less vocal within EU internal debates.

¶19. (SBU) The Czechs, who joined the EU in May 2004, assumed

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the rotating six-month EU presidency from the French on January 1, 2009 and handed over to the Swedes on July 1, 2009. This was the first time the Czech Republic held the EU presidency, and only the second time for one of the 12 newest EU member states. (Slovenia was the first, in January 2007.) In consultation with their EU partners, the Czechs focused on three top priorities underneath their overarching theme of "Europe Without Borders." These were: EU economic competitiveness, energy security, and external relations. Within external relations, the Czechs focused on the Western Balkans, Transatlantic Relations, and the Eastern Partnership. These priorities, along with the global financial crisis and the January 2009 Russian-Ukraine gas crisis, kept the Czechs extremely busy. While the Czechs were proud of what they accomplished during their first ever presidency, many Czech officials were disappointed that they

were unable to accomplish more, especially within the Balkans. Several EU member states (such as France) gave the Czechs mixed reviews for their presidency.

#### Energy Security

120. (C) Czech positions on energy security are generally very close to our own. They are a strong advocate within the EU for greater interconnectivity of internal EU gas and electricity networks and increased diversification of suppliers and routes. They are strong supporters of the Nabucco pipeline and hosted an EU-Southern Corridor Summit in May.  
Thompson-Jones